

**Financial Statements**  
**Gratiot County Community**  
**Mental Health Services**

**Alma, Michigan**

**September 30, 2004**



# Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name <b>Gratiot County Community Mental Health</b>	County <b>Gratiot</b>
Audit Date <b>9/30/04</b>	Opinion Date <b>12/14/04</b>	Date Accountant Report Submitted to State: <b>3/25/05</b>	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ Yes ☒ No 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☐ Yes ☒ No 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☐ Yes ☒ No 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ Yes ☒ No 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ Yes ☒ No 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ Yes ☒ No 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ Yes ☒ No 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ Yes ☒ No 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ Yes ☒ No 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

**We have enclosed the following:**

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGR).			✓

Certified Public Accountant (Firm Name) <b>ROSLUND, PRESTAGE &amp; CO., PC, CPA'S</b>			
Street Address <b>308 GRATIOT AVENUE</b>		City <b>ALMA</b>	State <b>MI</b>
Accountant Signature <i>[Signature]</i>		ZIP <b>48801</b>	Date <b>3/25/05</b>

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September 30, 2004

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## **INDEPENDENT AUDITOR'S REPORT**

Gratiot County Community Mental Health Services  
Alma, Michigan

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Gratiot County Community Mental Health Services (the Board), as of and for the year ended September 30, 2004, which collectively comprise the Board's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Board as of September 30, 2004, and the respective changes in financial position and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 14, 2004 on our consideration of the Board's internal control over financial reporting and our test of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis on pages I-IV, and budgetary comparison information on page 25, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Board's basic financial statements. The other supplemental financial information listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Roslund, Prestage & Co, PC*

Roslund, Prestage & Company, P.C.  
Certified Public Accountants

December 14, 2004

**MANAGEMENT'S DISCUSSION and ANALYSIS**

Gratiot County Community Mental Health  
Financial Statements for the Fiscal Year Ended September 30, 2004  
Management's Discussion and Analysis

The management of Gratiot County Community Mental Health Services Program (GCCMHSP) presents the following overview and analysis of the financial activities during the past year. This discussion and analysis is provided to introduce the basic financial statements of the past year and to provide the reader information to help assess whether the financial position has improved or deteriorated as a result of the year's operation.

**Basic Financial Statements:**

Two types of financial statements are provided: Government-wide Statement and Fund Statements.

Government-wide financial statements are designed to present the organization's finances in a layout similar to that of a private sector business. They consist of a Statement of Net Assets (providing historical balance sheet information) which shows the difference between assets and liabilities; and a Statement of Activities (providing historical income statement information) which shows revenues and expenses and the change in net assets from the previous year.

Fund financial statements offer a series of statements that focus on the major governmental funds. For GCCMHSP, the major funds consist of the following funds: General and Risk Management. Reconciliations are also offered between the Fund Financial Statements and the Government-wide Statements.

**Notes to Financial Statements:**

The Notes to Financial Statements, which immediately follow the financial statements, provide additional and more detailed information that is essential to a full understanding of the data provided in the financial statements.

Gratiot County Community Mental Health  
Financial Statements for the Fiscal Year Ended September 30, 2004  
Management's Discussion and Analysis

**Overview of Gratiot County CMH:**

GCCMHSP was created as a Mental Health Authority effective September 23, 1997 subsequent to a resolution by the Gratiot County Board of Commissioners. In 1998, GCCMHSP moved from fee for service funding to become a Managed Care Provider with sub-capitated Medicaid funding. Gratiot Community Mental Health still holds a Managed Mental Health Supports and Services Contract with the Michigan Department of Community Health for General Funds.

The 2002/2003 fiscal year was the beginning of a contract period in which the Department of Community Health contracted for Medicaid services through a designated Prepaid Inpatient Health Plan (PIHP) which had to consist of 20,000 or more Medicaid covered lives. GCCMHSP, which has approximately 5,700 Medicaid covered lives, along with four other Boards (Clinton Eaton Ingham Community Mental Health, Ionia County Community Mental Health, Newaygo County Community Mental Health, and Manistee-Benzie Community Mental Health) formed the Community Mental Health Affiliation of Mid-Michigan (CMHAMM) in order to meet the size requirements of the Michigan Department of Community Health's (MDCH) Application For Participation (AFP) for consideration as the PIHP for the region. Clinton Eaton Ingham (CEI) Community Mental Health was designated as the PIHP in this cooperative agreement and was awarded the Medicaid contract for the 8 county region. While meeting the size requirements were the catalyst for the formation of the Affiliation, a much more aggressive and robust vision emerged and has driven the work of the Affiliation into the 2003/2004 fiscal year.

As the region's PIHP, CEI Community Mental Health sub-contracts with GCCMHSP to provide needed mental health services to the Medicaid recipients in the county of Gratiot. This sub-capitated arrangement requires CEI to make a monthly payment to each CMH in the Affiliation for each Medicaid recipient living in their respective counties. The sub-capitated arrangement allows Gratiot County CMH to provide needed mental health services with great flexibility, as long as Gratiot County CMH complies with Medicaid standards and requirements. However, the state's Medicaid Mental Health and Substance Abuse Waiver renewal in late 2003 reinforced the requirement on CEI to ensure that Medicaid services are available, accessible, and medically necessary to meet the mental health and developmental disability needs of all of the Medicaid enrollees across the eight county region.



Gratiot County Community Mental Health  
Financial Statements for the Fiscal Year Ended September 30, 2004  
Management's Discussion and Analysis

This was reinforced through the requirement that the MDCH pay CEI Community Mental Health a single set of Medicaid rates for all of the Medicaid recipients living in the eight counties for which CEI is responsible. This single set of rates is a significant change to the CMH-specific rates that were paid to the PIHP, and passed onto each of its affiliates, in 2002 through 2003. Although the MDCH single rate took effect in January 1, 2004, a uniform payment rate, adjusted to meet local needs of each Affiliate CMH, will not be implemented until October, 2005 to allow for a sufficient time to assure the continuity of existing Medicaid services, in each community, as any necessary changes in service delivery methods are made.

**Financial Comparisons:**

The fiscal year 2003/2004 budget adopted by the governing board was \$9,996,597 of Revenues and \$9,859,747 of Expenses with an addition to fund balance of \$136,850. The Actual compared to Budget is presented below.

	Actual	Budget	Variance
Revenue	\$9,766,177	\$9,996,597	\$(230,420)
Expenses	\$9,633,905	\$9,859,747	\$225,842

The comparison of fiscal year 2003/2004 to fiscal year 2002/2003 is presented below.

	2003/2004	2002/2003	Variance
Revenue	\$9,766,177	\$9,421,441	\$344,736
Expenses	9,633,905	9,946,215	
Less: Capital Outlay financed by loans	-	(450,308)	
Sub-total	9,633,905	9,495,907	137,998
Revenues over (under) Expenses	\$132,272	\$(74,466)	\$206,738

Gratiot County Community Mental Health  
Financial Statements for the Fiscal Year Ended September 30, 2004  
Management's Discussion and Analysis

Fiscal year 2003/2004 actual revenue and actual expenses were proportionately both under budget. Expenses were reduced to compensate for lower capitated revenue areas while revenue was lowered in contract areas due to less billable expenses. Expenses slightly increased by approximately 1.4% during the 2003/2004 fiscal year after adjusting for capital outlay financed by loans.

It is not clear what the financial future will hold for Community Mental Health Boards. The State of Michigan is experiencing significant budgetary challenges and it is not clear what impact this will have. Also unclear is the effect that the proposed CMHAMM uniform payment rate will have on Gratiot County CMH. If significant reductions occur in Community Mental Health appropriations and/or Medicaid sub-capitation, GCCMHSP management and governing body will continue to analyze the services delivered, and the ways in which they are delivered, to determine where costs may be reduced and/or where revenues may be enhanced.

**BASIC FINANCIAL STATEMENTS -  
GOVERNMENT WIDE FINANCIAL STATEMENTS**

Gratiot County Community Mental Health Services  
Statement of Net Assets  
September 30, 2004 and 2003

	<u>Governmental Activities</u>	
	<u>2004</u>	<u>2003</u>
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$2,606,297	\$2,848,064
Accounts receivable	2,267	1,974
Due from other governmental units	184,174	115,756
Prepaid expenses	116,080	108,837
Total current assets	<u>2,908,818</u>	<u>3,074,631</u>
Noncurrent assets		
Restricted investments	141,308	139,881
Capital assets - depreciable, net	1,280,485	1,456,398
Capital assets - land	165,700	165,700
Total noncurrent assets	<u>1,587,493</u>	<u>1,761,979</u>
Total assets	<u>4,496,311</u>	<u>4,836,610</u>
<b>Liabilities</b>		
Current liabilities		
Accounts payable	614,158	545,012
Accrued wages and other payroll liabilities	148,623	246,211
Due to other governmental units	75,738	197,137
Deferred revenue	52,509	48,429
Current portion of long term debt	63,586	62,023
Total current liabilities	<u>954,614</u>	<u>1,098,812</u>
Noncurrent liabilities		
Compensated absences	161,207	149,844
Notes payable	781,855	845,304
Total noncurrent liabilities	<u>943,062</u>	<u>995,148</u>
Total liabilities	<u>1,897,676</u>	<u>2,093,960</u>
<b>Net Assets</b>		
Invested in capital assets, net of related debt	600,744	714,771
Reserved for risk management	27,005	177,902
Unrestricted	1,970,886	1,849,977
Total net assets	<u>\$2,598,635</u>	<u>\$2,742,650</u>

The Notes to the Financial Statements are an integral part of this statement.

Gratiot County Community Mental Health Services  
 Statement of Activities  
 For the years ended September 30, 2004 and 2003

Functions	Program Revenues			Net (Expense) Revenue and Changes Net Assets	2003
	Expenses	Charges for Services	Operating Grants and Contributions		
Governmental activities					
Health & Welfare - Mental Health	<u>\$9,910,511</u>	<u>7,806,249</u>	<u>1,940,829</u>	<u>(\$163,433)</u>	<u>(\$240,831)</u>
General revenues					
Unrestricted investment earnings				19,099	29,189
Restricted investment earnings				<u>319</u>	<u>1,505</u>
Total general revenues and contributions				<u>19,418</u>	<u>30,694</u>
Change in net assets				(144,015)	(210,137)
Net assets - beginning of year				<u>2,742,650</u>	<u>2,952,787</u>
Net assets - end of year				<u>\$2,598,635</u>	<u>\$2,742,650</u>

The Notes to the Financial Statements are an integral part of this statement.

**FUND FINANCIAL STATEMENTS**

Gratiot County Community Mental Health Services  
Balance Sheet  
Governmental Funds  
September 30, 2004 and 2003

	General Fund	
	2004	2003
<b>Assets</b>		
Cash and cash equivalents	\$2,579,292	\$2,670,162
Accounts receivable	2,267	1,974
Due from other governmental units	184,174	115,756
Restricted investments	141,308	139,881
Prepaid expenses	116,080	108,837
Total assets	<u>\$3,023,121</u>	<u>\$3,036,610</u>
<b>Liabilities</b>		
Accounts payable	\$614,158	\$545,012
Accrued wages and other payroll liabilities	148,623	246,211
Due to other governmental units	75,738	197,137
Deferred revenue	52,509	48,429
Total liabilities	<u>891,028</u>	<u>1,036,789</u>
<b>Fund balances</b>		
Reserved for prepaid expenses	116,080	108,837
Unreserved	2,016,013	1,890,984
Total fund balances	<u>2,132,093</u>	<u>1,999,821</u>
Total liabilities and fund balances	<u>\$3,023,121</u>	<u>\$3,036,610</u>

The Notes to the Financial Statements are an integral part of this statement.

Gratiot County Community Mental Health Services  
Reconciliation of Fund Balances on the Balance Sheet for Governmental Funds  
To Net Assets of Governmental Activities on the Statement of Net Assets  
For the year ended September 30, 2004

Total fund balance - governmental funds	\$2,132,093
Amounts reported for governmental activities in the statement of net assets are different because:	
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.	
Add: capital assets	2,325,044
Deduct: accumulated depreciation	(878,859)
An internal service fund is used by management to cover the risk of overspending the Managed Care Specialty Services Program contract. The assets and liabilities of the internal service fund are included in governmental activities in the statement of net assets.	
Add: net assets of governmental activities accounted for in the internal service fund	27,005
Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:	
Deduct: Notes payable	(845,441)
Deduct: Compensated absences	(161,207)
Net assets of governmental activities	<u>\$2,598,635</u>

The Notes to the Financial Statements are an integral part of this statement.



Gratiot County Community Mental Health Services  
Statement of Revenues, Expenditures and Changes in Fund Balances  
Governmental Funds  
For the years ended September 30, 2004 and 2003

Revenues	General Fund	
	2004	2003
State Grants		
Department of Community Health Contract	\$1,294,581	\$1,238,484
Other	6,217	5,636
Total state grants	<u>1,300,798</u>	<u>1,244,120</u>
Federal grants		
Federal block grants	126,335	53,882
OBRA grant	62,492	69,022
Total federal grants	<u>188,827</u>	<u>122,904</u>
Contributions - local units		
County appropriations	200,000	200,000
Other - FIA grants	111,303	115,496
Total contributions - local units	<u>311,303</u>	<u>315,496</u>
Charges for services		
Medicaid - CEI Contract	7,543,452	7,265,020
Medicaid - other	149,313	162,833
Client and third party pay	58,922	83,942
Other charges for services	54,562	73,001
Total charges for services	<u>7,806,249</u>	<u>7,584,796</u>
Interest and rents		
Interest	19,099	29,189
Rents	32,868	24,900
Total interest and rents	<u>51,967</u>	<u>54,089</u>
Other revenue		
United Way	12,503	11,598
Miscellaneous	94,530	88,438
Total other revenue	<u>107,033</u>	<u>100,036</u>
Total revenues	9,766,177	9,421,441

The Notes to the Financial Statements are an integral part of this statement.

Gratiot County Community Mental Health Services  
Statement of Revenues, Expenditures and Changes in Fund Balances  
Governmental Funds  
For the years ended September 30, 2004 and 2003

Expenditures	General Fund	
	2004	2003
Health & Welfare - Mental Health		
Personnel costs	\$4,224,865	\$4,004,668
Operating expenditures	5,285,453	5,352,511
Capital outlay	11,205	484,595
Debt service payments	112,382	104,441
Total expenditures	9,633,905	9,946,215
Revenues over (under) expenditures	132,272	(524,774)
Other financing sources (uses)		
Loan proceeds	-	450,308
Excess of revenues and other sources over (under) expenditures and other uses	132,272	(74,466)
Fund balance, beginning of year	1,999,821	2,074,287
Fund balance, end of year	<u>\$2,132,093</u>	<u>\$1,999,821</u>

The Notes to the Financial Statements are an integral part of this statement.

Gratiot County Community Mental Health Services  
Reconciliation of the Statement of Revenues, Expenditures  
And Changes in Fund Balances of Governmental Funds  
To the Statement of Activities  
For the year ended September 30, 2004

Net change in fund balances - total governmental funds	\$132,272
Amounts reported for governmental activities in the statement of activities are different because:	
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense.	
Add: capital outlay	11,205
Deduct: depreciation expense	(187,118)
An internal service fund is used by management to cover the risk of overspending the Managed Care Specialty Services Program contract. The net revenue (expense) of the fund attributable to those funds is reported with governmental activities.	(150,897)
Fixed assets acquired by long term loans are shown as an expenditure and other financing source in the governmental funds. The other financing source must be removed from the statement of activities; principal payments are applied to the debt liability; interest expense is recognized as it accrues.	
Add: principal payments on long term debt	61,886
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the funds.	
Less: increase in accrual for compensated absences	(11,363)
Change in net assets of governmental activities	<u>(\$144,015)</u>

The Notes to the Financial Statements are an integral part of this statement.

Gratiot County Community Mental Health Services  
Statement of Net Assets  
Proprietary Funds  
September 30, 2004 and 2003

	<u>Internal Service Funds</u>	
	<u>2004</u>	<u>2003</u>
Assets		
Cash and cash equivalents	<u>\$27,005</u>	<u>\$177,902</u>
Liabilities	-	-
Net Assets		
Restricted	<u>\$27,005</u>	<u>\$177,902</u>

The Notes to the Financial Statements are an integral part of this statement.

Gratiot County Community Mental Health Services  
Statement of Revenues, Expenses and Changes in Fund Net Assets  
Proprietary Funds  
For the years ended September 30, 2004 and 2003

	<u>Internal Service Funds</u>	
	<u>2004</u>	<u>2003</u>
Non-operating revenues (expense)		
Interest income	\$319	\$1,505
Operating transfers		
Transfers to affiliates	<u>(151,216)</u>	<u>-</u>
Change in net assets	(150,897)	1,505
Net assets, beginning of year	<u>177,902</u>	<u>176,397</u>
Net assets, end of year	<u><u>\$27,005</u></u>	<u><u>\$177,902</u></u>

The Notes to the Financial Statements are an integral part of this statement.

Gratiot County Community Mental Health Services  
Statement of Cash Flows  
Proprietary Funds  
For the years ended September 30, 2004 and 2003

	Internal Service Funds	
	2004	2003
Cash flows from operating activities	-	-
Cash flows from noncapital financial activities		
Transfers to affiliates	(\$151,216)	-
Cash flows from investing activities		
Proceeds from interest earnings	319	\$1,505
Net increase (decrease) in cash	(150,897)	1,505
Cash and cash equivalents, beginning of year	177,902	176,397
Cash and cash equivalents, end of year	<u>\$27,005</u>	<u>\$177,902</u>
Reconciliation of operating income to net cash provided by (used for) operating activities:		
Operating income (loss)	-	-

The Notes to the Financial Statements are an integral part of this statement.

**NOTES TO THE FINANCIAL STATEMENTS**

Gratiot County Community Mental Health Services  
Notes to Financial Statements

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting policies of the Gratiot County Community Mental Health Services (the Board) conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The following is a summary of the significant accounting policies used by the Authority.

In June of 1999, the GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. The significant changes included in Statement No. 34 include the following:

- A Management's Discussion and Analysis (MD&A) section providing an analysis of the Board's overall financial position and results of operations.
- Financial statements prepared using full accrual accounting for all of the Board's activities.
- A change in the fund financial statements to focus on major funds.

These and other changes are reflected in the accompanying financial statements (including the notes to the financial statements). The Board has implemented the provisions of Statement No. 34 effective October 1, 2002.

**Reporting Entity**

The Board operates as a Community Mental Health Board under the provisions of Act 258 - Public Acts of 1974, as amended. The Board provides funding for services in the areas of mental illness, developmental disabilities, and other related mental health needs for residents of Gratiot County.

The accompanying financial statements have been prepared in accordance with criteria established by the Governmental Accounting Standards Board for determining the various governmental organizations to be included in the reporting entity. These criteria include significant operational financial relationships that determine which of the governmental organizations are a part of the Board's reporting entity, and which organizations are legally separate, component units of the Board. Based on the application of the criteria, the Board does not contain any component units.



Gratiot County Community Mental Health Services  
Notes to Financial Statements

**Government-Wide and Fund Financial Statements**

The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the Board. For the most part, the effect of interfund activity has been removed from these statements. *Governmental activities*, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to consumers who purchase, use or directly benefit from services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than as program revenues.

Net assets are restricted when constraints placed on them are either externally imposed or are imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, generally it is the Board's policy to use restricted resources first, then unrestricted resources as they are needed.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds are reported as separate columns in the fund financial statements.

**Measurement Focus, Basis of Accounting and Financial Statement Presentation**

Government-Wide Financial Statements – The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Gratiot County Community Mental Health Services  
Notes to Financial Statements

Governmental Fund Financial Statements - The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Board considers revenues to be available if they are collected within 60 days of the end of the current fiscal year end. An exception to the "60 day" rule is the recognition of certain patient fee revenues and the related receivables. The Board has elected to recognize these revenues on the cash basis of accounting, which is in compliance with the Department of Community Health's revenue recognition formula. The difference between the cash basis of accounting and modified accrual basis of accounting for these revenues are not material to the financial statements.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include:

- Employees' vested annual leave is recorded as expenditures when utilized. The amount of accumulated annual leave unpaid at September 30, has been reported only in the government-wide financial statements.
- Interest on general long-term obligations is recognized when paid.
- Debt service expenditures and claims and judgments are recorded only when payment is due.

Proprietary Fund Financial Statements - The financial statements of the proprietary funds are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide statements described above.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, are followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. The principal operating revenues of the internal service fund are charges to other funds for insurance services. Operating expenses for internal service funds include the cost of claims, administration and reinsurance. Any revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Gratiot County Community Mental Health Services  
Notes to Financial Statements

The Board reports the following major governmental and proprietary funds:

Governmental Funds

General Fund – This fund is the Board's primary operating fund. It accounts for all financial resources of the Authority, except those required to be accounted for in other funds.

Proprietary Funds

Internal Service Fund - This fund represents amounts set aside to fund the net uninsured exposure of potential shortfalls of contract revenues.

**Comparative Data**

Comparative total data for the prior year has been presented in order to provide an understanding of the changes in financial position and operations. Also, certain amounts presented in the prior year may have been reclassified in order to be consistent with the current year's presentation.

**Budgetary Data**

The Board adopts an annual budget for the general fund. The budget is adopted and prepared on the modified accrual basis of accounting. The budget is adopted at the function level. The budgeted revenues and expenditures for governmental fund types, as presented in this report, include any authorized amendments to the original budget as adopted.

**Cash and Cash Equivalents**

The Board's cash and cash equivalents are considered to be cash on hand, money market funds, demand deposits and short-term investments with an original maturity of three months or less from the date of acquisition.

**Restricted Investments**

The Board has charged to the Department of Community Health the vested portion of compensated absences as of September 30. The Board holds a certificate of deposit for payment of the compensated absences liability, which is renewed on an annual basis.

Gratiot County Community Mental Health Services  
Notes to Financial Statements

**Receivables**

Accounts receivable in all funds report amounts that have arisen in the ordinary course of business and are stated net of allowances for uncollectible amounts.

Due from other governmental entities consist primarily of amounts due from the Michigan Department of Community Health and the State of Michigan.

**Prepaid Items**

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

**Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

**Inventories**

The Board does not recognize as an asset inventories of supplies. The cost of these supplies is considered immaterial to the financial statements and the quantities are not prone to wide fluctuation from year to year. The costs of such supplies are expensed when purchased.

**Fixed Assets**

Capital assets, which include property, plant and equipment, are reported in the governmental column in the government-wide financial statements. Capital assets are defined by the government as individual assets with an initial cost equal to or more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Gratiot County Community Mental Health Services  
Notes to Financial Statements

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during construction of capital assets is not capitalized. No interest expense was incurred during the current year.

Capital assets utilized in the governmental funds are recorded as expenditures in the governmental fund financial statements. Depreciation expense is recorded in the government-wide financial statements.

The Board does not have infrastructure type assets.

Capital assets of the Board are depreciated using the straight line method over the following estimated useful lives:

Assets	Years
Land	Not Depreciated
Buildings	15 – 25
Equipment	3 – 20
Vehicles	4

**Deferred Revenue**

Deferred revenues arise when resources are received by the Board before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, or when the Board has a legal claim to the resources, the liability for deferred revenue is removed from the fund financial statements and government-wide financial statements, and revenue is recognized.

**Compensated Absences**

Board policy allows full time employees to accumulate paid time off, at various rates, depending on the employee's length of service with the Board. The governmental fund financial statements record expenditures when employees are paid for these compensated absences. The government-wide financial statements record expenditures and the related liability when these compensated absences are earned by employees.

Gratiot County Community Mental Health Services  
Notes to Financial Statements

**Governmental Fund – Fund Balance Reserves and Designations**

The governmental fund financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditure or (2) legally segregated for a specific future use. The reserves for related assets such as prepaid items are examples of the former.

**Inpatient / Residential Cost Liability**

The amount recorded for inpatient / residential liability is based on management's estimate. This estimate is based on 1) the number of clients at each facility, 2) the number of days each client is at each facility, and 3) the daily rate charged for each facility.

The Board does not receive actual billings for these services until several months after the service date. Therefore, the liability is not liquidated within the normal 60 day period after year end. Also, the actual cost may vary from the estimated due to reimbursements from third party payors that are applied to the total cost before the billings are sent to the Board. This liability is included in accounts payable and due to other governmental units.

**NOTE 2 - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY**

**Budgetary Information**

Annual budgets are adopted at the function level and on a basis consistent with generally accepted accounting principles for all governmental funds. All annual appropriations lapse at fiscal year end. The Board does not maintain a formalized encumbrance accounting system. The budgeted revenues and expenditures, as presented in this report, include any authorized amendments to the original budget as adopted.

**Excess of Expenditures over Appropriations**

P.A. 621 of 1978, Section 18(1), as amended, provides that a local unit shall not incur expenditures in excess of the amount appropriated.

During the year ended September 30, 2004, the Board did not incur any expenditures in excess of the amounts budgeted.

Gratiot County Community Mental Health Services  
Notes to Financial Statements

**NOTE 3 - DETAIL NOTES**

**Cash and Cash Equivalents**

Michigan Compiled Laws, Section 129.91, authorizes the Board to deposit and invest in the accounts of Federally insured banks, credit unions, and savings and loan associations; bonds, securities and other direct obligations of the United States, or any agency or instrumentality of the United States; United States government or Federal agency obligation repurchase agreements; bankers' acceptance of United States banks; commercial paper rated by two standard rating agencies within the two highest classifications, which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions which are rated investment grade; and mutual funds composed of investment vehicles which are legal for direct investment by local units of government in Michigan. Financial institutions eligible for deposit of public funds must maintain an office in Michigan.

The Board's deposits are in accordance with statutory Authority.

At September 30, 2004, the carrying amount of the Board's cash deposits was \$2,605,797, and the bank balance was \$2,892,033. Of the bank balance, \$107,410 was covered by federal depository insurance and \$2,784,622 was uninsured and uncollateralized. Deposits which exceed FDIC insurance coverage limits are held at local banks.

The Board believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all bank deposits. As a result, the Board evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution. Only those institutions with an acceptable estimated risk level are used as depositories.

At September 30, the carrying amount of the Board's cash and cash equivalents was as follows:

	2004	2003
Petty Cash	\$500	\$500
Cash Deposits	2,605,797	2,847,564
Totals	\$2,606,297	\$2,848,064

Gratiot County Community Mental Health Services  
Notes to Financial Statements

The Board's investments can be classified into three categories to give an indication of the level of risk assumed. Category 1 includes investments that are insured or registered or securities held by the Board or its agent in the Board's name. Category 2 includes uninsured and unregistered investments which are held by the counterparty's trust department or agent in the Board's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent but not in the Board's name.

The Board's investments held at September 30, 2004 are classified as follows:

Investment In	Category 1	Carrying Value	Market Value
Certificates of Deposit	\$141,308	\$141,308	\$141,308

**Due From Other Governmental Units**

Due from other governmental units as of September 30, consists of the following:

	2004	2003
State of Michigan – Medicaid	\$55,780	\$30,417
Department of Community Health – Various Grants	70,599	34,985
Gratiot FIA	10,083	17,282
Other Governmental Units	47,712	33,072
Total	\$184,174	\$115,756

**Interfund Receivables and Payables**

As of the balance sheet date, there were no interfund receivables or payables.



Gratiot County Community Mental Health Services  
Notes to Financial Statements

**Changes in Fixed Assets**

A summary of changes in capital assets is as follows:

<b>Assets</b>	<b>Beginning Balance</b>	<b>Additions</b>	<b>Disposals</b>	<b>Ending Balance</b>
Buildings / land	\$1,339,513	-	-	\$1,339,513
Furniture, fixtures and equipment	321,745	-	-	321,745
Vehicles	670,406	\$11,205	(\$17,825)	663,786
Sub-totals	2,331,664	11,205	(17,825)	2,325,044
Accumulated depreciation	(709,566)	(187,118)	17,825	(878,859)
Totals	\$1,622,098	(\$175,913)	\$-	\$1,446,185

The proprietary fund did not have any capital assets as of September 30, 2004.

Depreciation expense was charged to the Health & Welfare – Mental Health Program.

**Due To Other Governmental Units**

Due to other governmental units as of September 30, consist of the following:

	<b>2004</b>	<b>2003</b>
Department of Community Health – Cost Settlement	-	\$3,372
Department of Community Health – Inpatient Services	\$15,351	27,329
Department of Community Health – Home Leases	-	24,259
CEI Community Mental Health Authority	58,881	118,976
Other Community Mental Health Agencies	1,506	23,201
Total	\$75,738	\$197,137

**Deferred Revenue**

The amount reported as deferred revenue represents the carry forward allowance for the general fund portion of the Department of Community Health's authorization.

**Accrued Wages and Other Payroll Liabilities**

This liability represents amounts paid to employees during October that was earned during September. Also included are employer payroll taxes.

Gratiot County Community Mental Health Services  
Notes to Financial Statements

**Long-Term Debt – Compensated Absences**

Board policy allows full time employees to accumulate “paid time off” at various rates, depending on the employee’s length of service with the Board. Amounts accumulated up to a maximum of 45 days are to be paid to the employee and recognized as an expense either when paid time off is used or upon termination of employment, provided the employee has worked for the Board for at least one year. As of September 30, 2004 and 2003, this liability was \$161,207 and \$149,844, respectively.

**Long-Term Debt – Building Loans**

*Building Loan – Wright Avenue*

During the 2001 fiscal year, the Board entered into a contract with a local bank to purchase real estate. Payments are due monthly in the amount of \$4,475, including interest at the rate of 5.25% per annum.

*Building Loan – Warwick Street*

During the 2003 fiscal year, the Board entered into a contract with the County of Gratiot to purchase real estate. Payments are due annually equal to the debt service requirements the County must pay for the related bond issue. Principal payments vary from \$25,000 to \$50,000 per year, and interest rates are from 7.3% to 7.8% per year.

*Building Loan – Miller Property*

During the 2003 fiscal year, the Board entered into a contract with a local bank to purchase real estate. Payments are due monthly in the amount of \$843, including interest at the rate of 4.75% per annum.

The annual installments to pay principal and interest on obligations outstanding at September 30, 2004 are as follows, including total interest payments of \$162,778.

Year Ended September 30,	Amount
2005	
2006	\$111,194
2007	113,740
2008	111,062
2009	569,618
2010-2014	50,655
	51,950

Gratiot County Community Mental Health Services  
Notes to Financial Statements

During the year, the following changes occurred in long-term debt:

Liability	Balance October 1, 2003	Additions	Reductions	Balance September 30, 2004
Compensated Absences	\$149,844	\$11,363	-	\$161,207
Building Loan – Wright Avenue	482,477	-	\$29,063	453,414
Building Loan – Warwick Street	270,000	-	30,000	240,000
Building Loan – Miller Property	154,850	-	2,823	152,027
Totals	\$1,057,171	\$11,363	\$61,886	\$1,006,648

**Compliance Audits**

All governmental grants are subject to a transactional and compliance audit by the grantors or their representatives. Therefore, an indeterminable contingency exists for expenditures, which may be disallowed by the granting agencies.

**Operating Leases**

The Board has entered into various operating leases for the use of real and personal property. Operating leases do not give rise to property rights or lease obligations, and therefore, the lease agreements are not reflected in the account groups.

The future minimum rental payments required under the operating leases that have initial or remaining noncancelable lease terms as of September 30, 2004 are as follows: \$17,405 for the September 30, 2005 fiscal year.

Gratiot County Community Mental Health Services  
Notes to Financial Statements

**Pension Plan**

The Board allows certain employees to participate in a defined contribution money purchase pension plan (Plan). The name of the Plan is the Gratiot County Community Mental Health Employee Alternative Retirement Plan.

The plan administrator is the Chief Financial Officer of the Board.

Effective May 1, 2002, all employees of the Board are eligible to participate in the Plan.

Employees contribute a mandatory 6.2% of their compensation to this plan. The Employer will contribute a Money Purchase contribution of 7.5% of compensation. Additionally, the employees may be entitled to share in a discretionary profit sharing contribution made by the employer. For the 2004 and 2003 year, this discretionary contribution totaled 6.2% and 6.2% of compensation, respectively.

For the September 30, 2004 and 2003 fiscal year, employer contributions to the plan totaled \$398,714 and \$360,520, respectively. The total payroll for the year ending September 30, 2004 and 2003 was \$3,312,842 and \$3,083,981, respectively.

Employee contributions and the employer discretionary profit sharing contributions vest 100% immediately. The vesting schedule for the employer money purchase contribution is as follows: 0% for the first 2 years of service, 50% after 3 years of service, 75% after 4 years of service, and 100% after 5 years of service.

**Risk Management**

The Board is exposed to various risks of loss related to theft of, damage to, and destruction of assets; errors and omissions; injuries; and natural disasters. The Board has purchased commercial insurance from independent insurance providers. Settled claims for the commercial insurance have not exceeded the amount of coverage in any of the past three years. There was no reduction in coverage obtained through commercial insurance during the past year.

Gratiot County Community Mental Health Services  
Notes to Financial Statements

**Risk Management – Internal Service Fund**

During the September 30, 1998 fiscal year, the Board authorized the establishment of an Internal Service Fund. This fund is used to cover the risk of overspending the Managed Care Specialty Services Program (MCSSP) contract. This contract provides for the use of Department of Community Health funding for the establishment of an Internal Service Fund, which is restricted to meet the expected future risk corridor requirements of the contract. Expenditures from the Internal Service Fund will occur when, in any one fiscal year, the Board finds it necessary to expend more to provide services necessary to carry out the MCSSP contract requirements than revenue provided to the Board by the contract.

**REQUIRED SUPPLEMENTAL INFORMATION**

Gratiot County Community Mental Health Services  
Statement of Revenues, Expenditures and Changes  
In Fund Balance - Budget and Actual  
General Fund  
For the year ended September 30, 2004

	Budgeted Amounts		Actual	Variance Between Actual and Final Budget
	Original	Final		
<b>Revenues</b>				
Local	\$314,747	\$295,703	\$470,303	(\$174,600)
State	8,883,129	9,320,892	9,107,047	213,845
Federal	203,732	189,754	188,827	927
Other Financing Sources	497,152	190,248	-	190,248
Total revenues and other financing sources	9,898,760	9,996,597	9,766,177	230,420
<b>Expenditures</b>				
Health and Welfare	9,802,653	9,736,160	9,510,318	225,842
Capital outlay	9,000	11,205	11,205	-
Debt service	-	112,382	112,382	-
Total expenditures	9,811,653	9,859,747	9,633,905	225,842
Revenues over (under) expenditures	87,107	136,850	132,272	4,578
Fund balance, beginning of year	2,231,287	2,231,287	1,999,821	(231,466)
Fund balance, end of year	\$2,318,394	\$2,368,137	\$2,132,093	(\$226,888)

The Notes to the Financial Statements are an integral part of this statement.

**OTHER SUPPLEMENTARY INFORMATION**



Gratiot County Community Mental Health Services  
Supporting Schedule of Personnel Costs  
For the years ended September 30, 2004 and 2003

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Governmental Fund Types

General Fund

	<u>2004</u>	<u>2003</u>
<b>Personnel Costs</b>		
Salaries And Wages	\$3,312,842	\$3,083,981
Fringe Benefits	<u>912,023</u>	<u>920,687</u>
Total Personnel Costs	<u><u>\$4,224,865</u></u>	<u><u>\$4,004,668</u></u>

The Notes to the Financial Statements are an integral part of this statement.

Gratiot County Community Mental Health Services  
Supporting Schedule of Operating Expenditures  
For the years ended September 30, 2004 and 2003

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Governmental Fund Types

General Fund

	<u>2004</u>	<u>2003</u>
<b>Operating Expenditures</b>		
Conferences	\$27,893	\$36,758
Contractual services	3,186,819	3,262,741
Dues / subscriptions	2,571	10,231
Indigent hospitalization	447,254	447,976
Institutional cost	236,013	139,435
Insurance	83,733	83,708
Mid-Michigan Industries program	355,018	347,879
Other	20,523	29,341
Printing / publishing	6,527	10,152
Rehabilitation costs	20,320	20,320
Rental	167,435	146,099
Repairs and maintenance	107,946	150,572
Respite care	90,297	50,418
Small equipment purchases	40,978	55,027
Supplies	206,247	260,144
Telephone	99,486	96,042
Travel & transportation	74,926	101,410
Utilities	111,467	104,258
	<u>111,467</u>	<u>104,258</u>
 Total operating expenditures	 <u><u>\$5,285,453</u></u>	 <u><u>\$5,352,511</u></u>

The Notes to the Financial Statements are an integral part of this statement.



**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Directors  
Gratiot County Community Mental Health Services  
Alma, Michigan

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Gratiot County Community Mental Health Services (the Board) as of and for the year ended September 30, 2004, which collectively comprise the Board's basic financial statements and have issued our report thereon dated December 14, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

**Compliance**

As part of obtaining reasonable assurance about whether the Board's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

**Internal Control over Financial Reporting**

In planning and performing our audit, we considered the Board's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the Board, in a separate letter dated December 14, 2004.

This report is intended for the information of the audit committee, management, and Board of Directors and is not intended to be and should not be used by anyone other than these specified parties.

*Roslund, Prestage & Co, PC*

Roslund, Prestage & Company, P.C.  
Certified Public Accountants

December 14, 2004



## MANAGEMENT LETTER

Board of Directors  
Gratiot County Community Mental Health Services  
Alma, Michigan

In planning and performing our audit of the financial statements for Gratiot County Community Mental Health Services for the fiscal year ended September 30, 2004, we considered the internal control structure to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control structure.

However, during our audit we became aware of matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions regarding those matters.

This letter does not affect our audit report dated December 14, 2004 on the financial statements of Gratiot County Community Mental Health Services.

We will review the status of these comments during our next audit engagement. We have discussed these comments and suggestions with management, and will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

Sincerely,

Roslund, Prestage & Company, P.C.  
Certified Public Accountants

December 14, 2004

### **Perform a Fraud Risk Assessment**

In light of the wave of notorious frauds involving large companies in the last few years, such as Enron, WorldCom, and HealthSouth, there may be a misperception that fraud affects only large companies. However, fraud occurs in companies of all sizes, and almost any employee may be capable of perpetrating a fraudulent act given the right set of circumstances. In fact, fraud may be a more significant problem for small companies. In the 2002 survey of its members conducted by the Association of Certified Fraud Examiners (ACFE), the median loss per fraud occurrence reported from businesses with 100 or fewer employees was \$127,500, a proportionately larger loss than the \$97,000 median loss in companies with 10,000 or more employees.

Whereas the highly publicized frauds at large public companies like Enron, WorldCom, and HealthSouth involved fraudulent financial reporting, for small companies, one of the primary fraud risks is the ever-present risk of misappropriation of assets (theft), particularly fraudulent cash disbursements. The opportunity to commit and conceal fraud exists where there are assets susceptible to misappropriation and there are inadequate controls to prevent or detect the fraud. To address this risk, we recommend that the Authority perform a risk assessment to identify, analyze, and manage the risk of asset misappropriation. Risk assessment, including fraud risk assessment, is one element of internal control. Thus, ideally, the Authority's internal control should include performance of this assessment, even though our annual financial statement audits include consideration of fraud.

The fraud risk assessment can be informal and performed by a management-level individual. Ordinarily, the management-level individual would conduct interviews or lead group discussions with personnel who have extensive knowledge of the Authority, its environment, and its processes. The fraud risk assessment process should consider the Authority's vulnerability to misappropriation of assets. When conducting the self-assessment, questions such as the following can be considered:

- Which individuals in the Authority have the opportunity to misappropriate assets? These are individuals who have access to assets susceptible to theft and to records that can be falsified or manipulated to conceal the theft.
- Are there any known pressures that would motivate individuals with the opportunity to misappropriate assets? Pressures may relate to financial stress or dissatisfaction. In assessing whether these pressures may exist, the assessor should consider whether there is any information that indicates potential financial stress or dissatisfaction of individuals with access to assets susceptible to misappropriation.
- What assets of the Authority are susceptible to misappropriation?
- Are there any known internal control weaknesses that would allow misappropriation of assets to occur and remain undetected?

**Perform a Fraud Risk Assessment (continued)**

- How could assets be stolen? Assets can be stolen in many ways besides merely removing them from the premises. For example, cash can be stolen by writing checks to fictitious individuals or vendors and cashing them for personal use. Inventory or other assets can be stolen through sales to fictitious customers.
- How could potential misappropriation of assets be concealed? Because many frauds create accounting anomalies, the perpetrator must hide the fraud by running it through as an adjustment to another account. Generally, fraud perpetrators may use accounts that are not closely monitored.
- What factors might indicate that the Authority has a culture or environment that would enable management or individuals to rationalize committing fraud?

Once areas vulnerable to fraud have been identified, a review of the Authority's systems, procedures, and existing controls relating to the identified areas should be conducted. The Authority should consider what additional controls need to be implemented to reduce the risk of fraud. There are two basic types of controls—those that are designed to address specific types of fraud, and those that are more general in nature. General controls that reduce an individual's ability to commit fraud without detection include the following:

- Requiring Periodic Job Rotation and Mandatory Vacations. When an employee stays in the same position for a long period and has few absences, an opportunity exists for that employee to design and commit fraud schemes. Requiring key individuals to rotate jobs periodically or to transfer to different job functions is one way to address this fraud risk. Requiring all individuals to take an annual vacation, during which time others perform their job functions, also makes it more difficult for an employee who is committing fraud to continue concealing the fraud scheme.
- Preparing and Reviewing Monthly Financial Statements in a Timely Fashion. As previously mentioned, many frauds create accounting anomalies. Thus, one way to detect fraud on a timely basis is to review monthly financial statements and investigate unusual variances. If possible, these statements should include budget, prior period, and year-to-date amounts to help identify variances. Performing the review and investigation on a timely basis helps minimize the extent of potential fraud.
- Implementing an Employee Hotline. Tips and complaints from fellow employees or vendors have enabled many companies to discover occurrences of fraud. Anonymous telephone hotlines allow honest employees and vendors who may fear retaliation from fraud perpetrators to report unethical behavior without risking exposure.

### **Perform a Fraud Risk Assessment (continued)**

Examples of controls to prevent or detect specific types of fraud include the following:

- Independent Checks of work performed. Independent checks test another employee's work, such as by having a second employee re-perform or test an employee's work.
- Separation of Duties. Separation of duties is one of the most effective controls to prevent or detect misappropriations of assets. When possible, incompatible duties should be performed by different employees. For example, the responsibility for authorizing transactions, recording transactions, and maintaining custody of assets should be assigned to different people in the Authority to the extent possible.

When assessing the Authority's internal control, the relationship between the nature and extent of fraud controls recommended and the cost of implementing those controls should be considered. For example, instead of trying to prevent fraud, the Authority may choose to use more detective controls to ensure that the fraud is identified and corrected in a timely fashion. Because detective controls are performed after the original transaction occurs, they may be easier to implement and more cost effective.

We would be pleased to provide more information about performing a risk assessment or assist management in performing one.

### **Review Payroll Records for Unusual Matters**

Performing a careful review of the payroll register (that is, the schedule showing the calculation of gross pay, deductions, and net pay) and payroll check register can highlight several types of payroll fraud. We recommend that an appropriate person periodically make such a review, being alert for unusual matters that might suggest fraud, such as the following:

- Duplicate names or addresses.
- Names of former employees.
- Math errors (which may indicate diversion of payroll or payroll taxes).
- Unusual pay rates or numbers of hours worked.
- Factors that may indicate ghost employees.